

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL.)

August 15, 2007

Dear Xxxxx:

This letter is in response to your letter dated May 22, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.ILTAX.com](http://www.ILTAX.com) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

My client provides an electronic data information service ('SERVICE') through wireless internet connection that allows subscribers (i.e. doctors, nurse practitioners, etc.) to quickly and more accurately check for harmful drug-drug and drug-allergy interactions, eliminate pharmacy callbacks due to illegibility, drug incompatibility or ineligibility, access patient-specific drug history, automatically link to real-time patient eligibility and up-to-date formularies, access a comprehensive online drug reference guide and immediately transmit prescriptions to any pharmacy or print to paper for patient to take to any pharmacy. The SERVICE assists sponsors (i.e. insurance companies, etc.) and subscribers by improving cost savings, patient safety, and office efficiency.

Sponsors generally purchase the SERVICE in order to reduce costs related to prescription medication. The initial deployment of the services is billed as a bundled package of hardware, software and service subscription and is one single line item on an invoice. The sponsors give the bundled package to the doctors within their network. The hardware and software remains with the purchaser (i.e. sponsor) or purchaser's related parties (i.e. doctors, etc.) even if the subscription is not renewed or cancelled.

The hardware and software are merely means to securely access the medical, patient and prescription data of the SERVICE in order to provide information on the most effective and least harmful medicine for a patient. The actual medical, patient and prescription data is held in a data center at the Client's corporate location not on the

handheld device used by the doctor. The hardware and software are simply a means by which the doctors can access the required information from the data center.

There may be from time to time enhancements to the service or software that will be delivered electronically. The costs for these updates/upgrades are part of the subscription cost, along with technical support and maintenance.

There are several revenue streams identified in the section labeled '**Summary of SERVICE and Revenue Streams**'. Based on the descriptions of the service above and the revenue streams we request a taxability decision and code, statute or ruling references on the questions that follow.

1. Is the SERVICE taxable or non-taxable and does the taxability change based on bundled or separated invoice line items?
2. Are there any use tax implications to consider if the service or any other items offered with the service are determined to be non-taxable?
3. If the hardware is determined to be taxable can a resale certificate be issued at the time of purchase by my client?
4. What is the taxability of all of the revenue streams identified on the 'Summary of SERVICE and Revenue Streams'?
5. Would there be any medical related exemptions offered to the sponsors or subscribers?

If you have any questions please give me a call.

### **Summary of SERVICE and Revenue Streams**

**SERVICE-** Is an electronic data information service that allows subscribers (i.e. doctors, nurse practitioners, etc.) to quickly and more accurately check for harmful drug-drug and drug-allergy interactions, eliminate pharmacy callbacks due to illegibility, drug incompatibility or ineligibility, access patient-specific drug history, automatically link to real-time patient eligibility and up-to-date formularies, access a comprehensive online drug reference guide and immediately transmit prescriptions to any pharmacy or print to paper for patient to deliver to any pharmacy. The SERVICE assist sponsors (i.e. insurance companies, etc.) and subscribers by improving cost savings, patient safety, and office efficiency.

**Initial Deployment Fee-** An agreed upon fixed rate of revenue derived from the delivery of all or some of the following in conjunction with the purchase of the SERVICE invoiced as a bundled package including:

- One SERVICEing hardware device, generally a 'Pocket PC' consisting of a Dell Axim with wireless networking card or equivalent successor Pocket PC.
- If required, Wireless Access Point ABC or substantially equivalent access point, associated cables, and router along with the installation of such cables and router as applicable. *(Title to the Pocket PC and related wireless networking equipment passes to either the doctor or to the subscription sponsor. Client does not maintain title to any hardware.)*

- Web Browser mode for using the SERVICE if the Sponsor Prescriber elects to not be issued a hardware device. *(The web browser is loaded on to any PC in the doctor's office)*
- One year license to use the SERVICE, including the Drug Reference Guide.
- One year license for all subscribers' support staff. *(Only for those who can prescribe drugs and requested by the doctor).*
- On-site installation
- Introductory training
- Technical support and maintenance, coterminous with the term of the one year SERVICE license
- Initial patient demographic data load *(one per practice)*
- Any software updates are sent electronically to the doctors during the term of service.

**License Renewal Fee-** Revenue derived from the renewal of a one-year license to the SERVICE. The hardware and software are tools that allow a subscriber to have access to the SERVICE *(Client does not have title to the hardware so even if a customer does not renew they keep the equipment.)*. The license renewal includes:

- Access to the service (An activated log-in and access code)
- Software updates
- Service or software enhancements
- Maintenance
- Technical support

**Script Fees-** An agreed upon rate to be paid for each prescription for an eligible, insured individual that is written using the SERVICE. These fee agreements are in place with sponsors and Pharmacy Benefit Managers ('PBM'). In some cases, the script fee agreements with sponsors are an incentive based fee that subsidizes a reduced Initial Deployment fee for a specified term usually not longer than 18 months and are not included in the license renewal agreement. The script fee agreement with the PBM's generally last for the life of the agreement. Doctors' write prescriptions through the SERVICE that get routed to the PBM. The PBM pays a script fee to the Client for every prescription received from doctors through the SERVICE.

**Proxy Payments-** Revenue derived from an agreed upon percentage of the cost saving to be paid by the sponsor for savings directly related to a reduction in cost due to a change in a subscribers prescribing behavior as indicated by the advantages and benefits listed under the SERVICE stated above.

## **DEPARTMENT'S RESPONSE:**

We cannot give you specific guidance without reviewing the actual contracts and billings between the parties involved. However, the following information should provide you with guidance regarding the services described in your letter.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases

occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. Tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways:

- (1) separately stated selling price of tangible personal property transferred incident to service;
- (2) 50% of the servicemen's entire bill;
- (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or
- (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction-by-transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers

are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

Please be aware that sales of prewritten ("canned") computer software are taxable retail sales of tangible personal property in Illinois. See 86 Ill. Adm. Code 130.1935. Sales of canned software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable. Software updates for canned software are also generally considered taxable.

All gross receipts from sales of tangible personal property in Illinois are subject to Retailers' Occupation Tax unless an exemption is specifically provided. Food, drugs, medicines and medical appliances are not taxed at the normal rate of 6.25%. These items are taxed at a lower rate of 1% plus any applicable local taxes. See Ill. Adm. Code 130.310. Products that do not meet the appropriate definitions of food, drugs, medicines and medical appliances, or are food prepared by the vendor for immediate consumption, are taxable at the higher State sales tax rate of 6.25% plus applicable local taxes.

The definition of a medical appliance is "an item which is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body." Diagnostic, treatment, and rehabilitative equipment items do not qualify for the reduced rate of tax as medical appliances because such items are not for use in directly substituting for a malfunctioning part of the body. See 86 Ill. Adm. Code 130.310(c)(2). It does not appear that any of the items listed in your letter would qualify for the reduced rate of tax.

I hope this information is helpful. If you require additional information, please visit our website at [www.ILTAX.com](http://www.ILTAX.com) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

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TDC:msk